

Department of Energy

Office of the Chief Financial Officer



Implementing OMB A-123, Appendix A **DOE A-123 at a Glance**

Version 5.0

September 2007

<http://www.cfo.doe.gov/progliaison/doeA123/index.htm>

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BACKGROUND

In December 2004, the Office of Management and Budget (OMB) released a revised Circular A-123. While changes were made throughout the document, the most critical changes were concentrated in the newly added Appendix A, Internal Control over Financial Reporting. The primary changes were strengthened documentation, monitoring and testing requirements. The documentation requirements not only became more detailed, but were also expanded to include both documentation of internal controls and documentation of the methodology and process used to make the attestations. Testing was strengthened by requiring tests of the operating effectiveness of controls. Monitoring was strengthened by requiring a continuous cycle of evaluation, testing and, where necessary, remediation of those controls that are not designed or operating effectively.

The ultimate intent of the revised Circular was to "strengthen the process management used to assess internal control over financial reporting." The Department of Energy (Department or DOE) understands that it is management's fundamental responsibility to develop and maintain effective internal controls. As such, it has established a corporate program to effectively implement and manage the requirements of OMB A-123, Appendix A.

IMPLEMENTATION APPROACH

Initial Ramp-up

The Department has elected to pursue a three-year implementation strategy due to the complexities and interdependencies of implementing A-123. This strategy provides for a "complete" (qualified or unqualified) assurance in FY 2008. A summary of the three-year implementation approach is identified below.

	FY 2006	FY 2007	FY 2008
Federal Sites	Complete documenting, evaluating and testing of high-risk activities that are most critical to financial statement remediation efforts.	Complete documenting, evaluating and testing of remaining high-risk activities and all medium-risk activities.	Complete documenting, evaluating and testing of all low-risk activities. Baseline for Federal activities is established.
Non-Federal Site Contractors	Complete documenting, evaluating and testing of all high-risk activities	Complete documenting, evaluating and testing of all medium-risk and low-risk activities. Baseline for contractor activities is established.	Document, evaluate and testing all activities under an Annual Risk-based Controls Assessment methodology.
Year-end Assurance	Provide a qualified assurance on November 15, 2006, due to limited scope.	Provide a qualified assurance on November 15, 2007, due to limited scope.	Provide assurance on November 15, 2008 (qualified or unqualified)

The same kind of start up strategy may be used for new A-123 Implementations.



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ANNUAL RISK-BASED CONTROL ASSESSMENT (ARCA)

Once Departmental elements have completed their baseline assessments, they will implement an **A**nnual **R**isk-based **C**ontrols **A**ssessment (ARCA). This methodology allows Local Implementation Teams to easily identify, plan for, implement and monitor their current year and out-year assessment scope. The ARCA methodology is based on the OMB requirement that all controls be tested at least every three years. Key design principles of ARCA include,

- Managing the assessment at the sub-process/sub-category levels
- Monitoring corporate risk criteria that define potential impacts to the operational environment and assessment scope
- Enabling 3-year planning by providing the visibility of all activities and allowing adjustments across the 3-year cycle
- Providing Local Management the flexibility to manage local assessments based on local criteria, including Local Risk Criteria and defining cyclical reviews based on Risk Assessment Ratings.

Managing the Assessment

The ARCA methodology manages the scope at the sub-process and sub-category levels in order to simplify and more effectively perform the annual controls assessment. This approach is supported by the ARCA tool through an automated aggregation of the associated risk activities to the sub-process/sub-category level.

Monitoring Corporate Risk Criteria

The ARCA methodology applies a series of risk criteria that, if triggered, cause the sub-process / sub-category to be assessed during the current year. In the absence of any risk criteria the assessment would be truly cyclical (i.e., based on the oldest test date and a three year cycle). The effect of the triggering of the risk criteria is to drive the proactive monitoring of new areas of risk and is intended to mitigate the Department's overall risk.

Enabling 3-year Planning

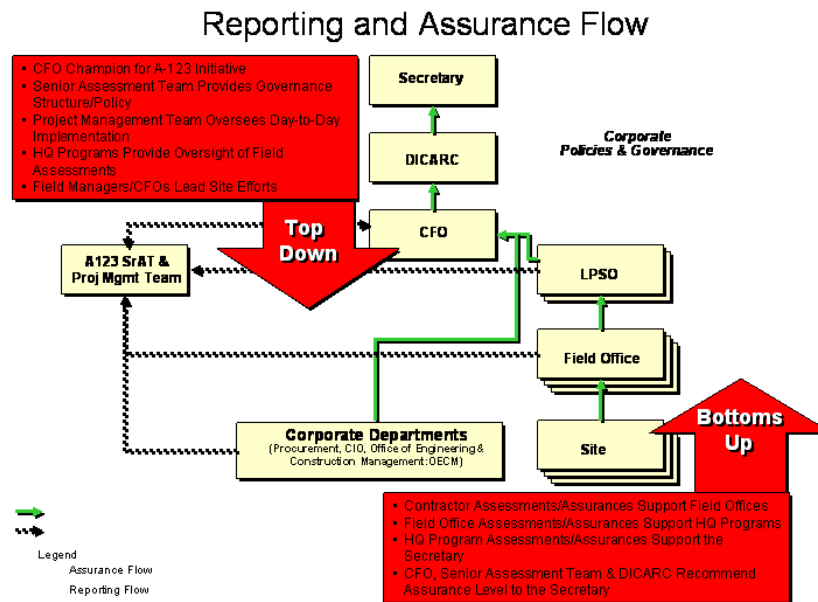
The ARCA methodology identifies the annual assessment scope after allowing Local Implementation Teams to delay (for valid reasons) or pull forward assessment scope, over a 3-year planning horizon. This flexibility provides for better local planning of the assessment, as well as better management of local implementation resources.



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GOVERNANCE STRUCTURE / RESPONSIBILITIES

The Department manages its A-123 program through a defined governance structure and by means of a top-down implementation approach. This governance structure, and the associated reporting and assurance flow, is depicted below.



A. Responsibilities

This governance structure and the responsibilities of the respective Departmental Elements are as follows:

- Secretary of Energy** – signs the annual assurance statement on the Department's effectiveness of internal control over financial reporting as of June 30 for the fiscal year being reported. The annual assurance statement is included in the Department's annual Performance and Accountability Report, issued November 15 of each year.



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- **Departmental Internal Control and Audit Review Council (DICARC)** – provides senior management oversight of the Department's internal control program. DICARC reviews and approves material weaknesses in internal control over financial reporting as identified by the annual Appendix A, assessment process and determines the level of Secretarial assurance the Department should provide on its internal control over financial reporting. (DICARC also reviews and approves material weaknesses in internal controls, and the level of Secretarial assurance provided, for annual assessments of internal control required by the Federal Managers' Financial Integrity Act and the Federal Financial Management Improvement Act.)
- **Departmental Chief Financial Officer (CFO)** – established a Senior Assessment Team and an A-123 Project Management Team to oversee the Department's efforts to implement the requirements of Appendix A.
- **Senior Assessment Team (SrAT)** – recommends to the DICARC the level of Secretarial assurance the Department should provide on its internal control over financial reporting. The SrAT also:
 - identifies the material accounts from the Department's quarterly and annual financial statements upon which the annual assessment of internal control over financial reporting will be based;
 - identifies key financial and business processes that impact the material accounts and the;
 - identifies the Departmental elements, Corporate Departments, and major site and facilities management contractors that will be included in the assessment;
 - evaluates, on an overall basis, the design and operation of internal control over financial reporting based in large part on the quarterly and annual assessments from Heads of Headquarters and Field Elements; and,
 - develops a process for identifying changes in the internal control environment from June 30 to fiscal year-end that could potentially impact the effectiveness of internal control over financial reporting.

The membership of the SrAT includes the following:

- Director, Office of Internal Review (serves as Chairperson)
- Director, Office of Financial Management
- Director, Energy Finance and Accounting Service Center
- NNSA Field Chief Financial Officer/Director, Office of Field Financial Management
- Chief Financial Officer, Oak Ridge Operations Office
- Chief Financial Officer, Savannah River Operations Office
- Ex Officio representatives (e.g., Office of Inspector General staff) (non-voting technical advisors)



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- **Headquarters A-123 Project Management Team (PMT)** – provides operational oversight of, and support for, evaluations of internal control over financial reporting being conducted by Departmental elements, Corporate Departments, and major site and facilities management contractors. The A-123 PMT also supports the corporate governance and policy-making responsibilities of the SrAT by developing and maintaining policy, guidance, tools, templates, and other items necessary for the Department's implementation of Appendix A.
- **Heads of Headquarters and Field Elements** – develops and maintains effective systems of internal control; conducts assessments of internal control over financial reporting; and reports results (quarterly status reports and annual assurance statements) on the financial-reporting related internal controls under their cognizance. Heads of Headquarters Elements, in this context, refers to Lead Program Secretarial Offices and Corporate Departments (e.g., the Office of Headquarters Procurement Services, the Office of the Chief Information Officer and the Office of Engineering and Construction Management). Heads of Field Elements, in this context, refers to Field Office Managers. Heads of Headquarters and Field Elements may delegate these responsibilities (with the exception of the signing of the annual assurance statement) to others, such as the resident A-123 Assessment Teams; any such delegation shall be documented in writing.
- **Field Chief Financial Officers** – supports the Head of Field Elements' assessments and provides liaison with the major site and facilities management contractors under its cognizance. Field CFOs may delegate these responsibilities to others, such as the resident A-123 Assessment Teams; this delegation does not need to be documented in writing.
- **A-123 Assessment Teams** (Local Assessment Teams) – established by Heads of Headquarters and Field Elements, with major site and facilities management contractor involvement as appropriate, to conduct evaluations of the effectiveness of internal control over financial reporting. A-123 Assessment Teams also:
 - conduct an evaluation based on material accounts and key financial and business processes identified by the SrAT;
 - develop test plans;
 - prepare quarterly status reports on progress in assessing systems of internal controls; and,
 - prepare annual assertions on internal control over financial reporting.
- **Major Site and Facilities Management Contractors** – implements, under the direction and oversight of the cognizant Field Element, the requirements of Appendix A, as applicable.



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Scope / Materiality / Process Identification

The Department has clearly defined the scope of reporting to be considered, materiality levels and key processes as detailed below. Material accounts have been developed at the corporate level and are driven down to programs and sites as applicable. To ensure consistent evaluation, testing and reporting, the PMT has also defined standard process cycles and related processes that have been deployed across the complex. This approach will provide the needed consistency and structure to ensure an effective implementation.

B. SCOPE OF FINANCIAL REPORTS

The Department's SrAT established a scope of financial reports that covers the Department's six principle financial statements. These statements include:

1. **Consolidated Balance Sheet:** Captures assets, liabilities and net position components of the Department.
2. **Consolidated Statements of Net Cost:** Summarizes the Department's operating costs by the seven long-term goals identified in the Department's Strategic Plan. Also includes "Net Cost of Transferred Operations."
3. **Consolidated Statements of Changes in Net Position:** Presents accounting events that caused changes in the net position section of the Consolidated Balance Sheets from the beginning to the end of the reporting period.
4. **Combined Statement of Budgetary Resources:** Provides information on budgetary resources available to the Department during the year and the status of those resources at the end of the year.
5. **Consolidated Statements of Financing:** Reconciles the obligations incurred to finance operations with the net cost of operations.
6. **Consolidated Statements of Custodial Activities:** Identifies revenues collected by the Department on behalf of others.



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The decision was made to limit the Department's baseline assessment to the six principal financial statements due to the implementation of a new, Oracle-based accounting system in FY 2005. Transition issues and other factors associated with the implementation of this new financial system resulted in a disclaimer of opinion on the Department's FY 2005 financial statements. The SrAT decided that the most critical financial reporting areas that could benefit from the rigors of an A-123 assessment were the principal financial statements. As such, the current assessment work will not only satisfy the requirements of A-123, but also support the Department's efforts to regain an opinion on its statements. As the Department moves forward with its A-123 implementation, the SrAT will consider expanding the assessment scope to include other types of financial reports.

C. MATERIALITY

Department of Energy Methodology

Materiality determination is a complex analysis that requires professional judgment and consideration of various quantitative and qualitative measures. The SrAT defined two quantitative materiality levels in accordance with Office of Management and Budget (OMB) Circular A-123, Appendix A:

Reporting Materiality is the overall materiality that serves as the threshold for reporting weaknesses in internal controls that could result in a material misstatement of a financial report. The SrAT set Reporting Materiality at 1% of Total Assets, consistent with the President's Council on Integrity and Efficiency Financial Audit Manual (FAM) approach.

Planning Materiality, which is generally a percentage of reporting or overall materiality, is used to determine significant accounts, elements or disclosures in a financial report. Planning Materiality is calculated at two levels – Departmental and site. An account is considered to be material at the Departmental Level if the account balance is \geq .75% of Total Assets (\$895 million). An account that is material at the Departmental level is considered to be material at the site level if the site's account balance is \geq .75% of the total account balance. For example, if the total accounts payable balance for the Department is \$1 billion, accounts payable will be material at any site that has an accounts payable balance \geq \$7.5 million (.75% of \$1 billion).

In addition, the SrAT considered a number of qualitative factors when assessing the significance of an account, such as susceptibility to loss due to fraud, volume of activity, complexity, nature of the account, etc. The Department also considered the accounts and cycles identified by the independent financial statement auditor.



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Additionally, the Department will identify the financial report assertions associated with each material account for documentation purposes and to assist in testing. Financial reporting assertions are defined as representations by management that are embodied in the financial statements and are classified in the following broad categories:

Presentation and Disclosure – Financial statement account is properly classified, described and disclosed.

Existence or Occurrence – Assets or liabilities exist at a given date and whether recorded transactions occurred during a given period.

Rights and Obligations – Assets are the rights of the entity and liabilities are obligations of the entity at a given date.

Completeness and Accuracy – All transactions and accounts that should be presented are included.

Valuation and Allocation – Assets, liabilities, equities, revenues and expenses have been included at appropriate amounts.

Material Accounts

The Department's three-year implementation approach requires that material accounts remain fairly constant so that processes and status against the Department's commitments to OMB can be adequately tracked. Although material accounts at the Departmental level are not expected to change during the three-year baseline assessment period, Federal sites will determine whether significant changes have occurred at their location or at contractor locations over which they have cognizance, which would necessitate a change to their local material accounts.



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D. KEY PROCESS CYCLES AND PROCESSES

To support the consistent assessment of internal control over financial reporting, the Department has established 5 standard process cycles and 19 standard processes around which A-123 assessments will be performed. The process cycles and related key processes are listed below:

Procure to Pay (P2P) cycle comprises the Purchasing and Payment Processes including: *Acquisition; Inventory Management; Payable Management; and Travel*. Some examples of specific areas that may contain risks are approving requisitions, issuing RFP's, maintaining and selecting vendors, awarding contracts, maintaining obligations, receiving and managing goods or services, approving and paying invoices, tracking funds, monitoring continuing resolutions, managing travel and purchase cards.

Budget to Close (B2C) basically encompasses Financial and/or Accounting Processes such as: *General Ledger Management; Funds Management; Funds Balance with Treasury; Cost Management; Insurance; Grants; and Loans*. Sub-processes include such activities as budgeting, journal entries, costing reconciliations, financial reporting and include closing activities at month, quarter, and year-end.

Projects to Assets (P2A) involves *Project Cost Management; Property Management; and Seized Property Management* processes. Selected sub-processes that fall within this process cycle are managing large projects including capturing all costs and managing to budget; capturing costs for reimbursable expenses; creating and monitoring assets; monitoring depreciation; and controlling property.

Quote to Cash (Q2C) consists of *Revenue Management; and Receivable Management*. The Sub-Processes attached to this process cycle include invoicing for reimbursable expenses, as well as any other expected revenues through to managing accounts receivable and receiving cash.

Enterprise Resource Management (ERM) incorporates all aspects of *Human Resources; Payroll; and Benefits*. The sub-processes include the full gamut of activities from hiring and managing employees to executing benefits for all employees and retirees. This includes calculating liabilities, as well as creating accruals.



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In the context of A-123, Appendix A, a:

Process Cycle is an end-to end sequence of events consisting of the methods and records used to establish, identify, assemble, analyze, classify and record transactions. The process cycles were developed based on Enterprise Resource Planning best practices.

Process is the highest-level categorization of activities within a process cycle. This level aggregates various sub-processes against which A-123 assessments are performed. The processes were developed based on analysis of Joint Financial Management Improvement Program manuals and the Council of Sponsoring Organizations (COSO) Internal Control Framework. These processes have been tailored to "fit" DOE financial management operations.

Sub-process is the lowest level categorization of activities within a process cycle or process. Sub-processes define the specific grouping of activities against which controls are directly assessed (e.g. controls and related risks are identified at this level and evaluation and testing are performed at this level).

FUNCTIONAL ACTIVITIES

To further support a consistent assessment of internal control over financial reporting, the Department has also established 7 functional activities which will be performed during the execution of the A-123 assessment scope. The 7 functional activities are listed below:

E. PLANNING

All key decisions that drive the A-123 assessment are made during the Planning phase, and as such planning is one of the most critical steps in the assessment process. The Planning phase of the A-123 program requires the Headquarter and Field Elements to establish A-123 Assessment Teams, determine their contractor management strategy, select relevant material accounts and complete an A-123 Implementation Plan.



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F. DOCUMENTING

The A-123 Assessment Teams will document its understanding of the entity's internal control over financial reporting. The form and extent of documentation depends in part on the nature and complexity of the controls; the more extensive and complex the controls, the more extensive the documentation.

The A-123 Assessment Teams will also document the assessment process of internal control over financial reporting including:

- (1) Establishing respective teams, their authority and members;
- (2) Identifying contracting actions if contractors are used to perform or assist in the assessment;
- (3) Communicating with site management and employees regarding the assessment;
- (4) Identifying key decisions;
- (5) Assessing methodology and guidance;
- (6) Assessing internal controls at the entity, process, transaction and application levels;
- (7) Testing controls and related results;
- (8) Identifying deficiencies and suggestions for improvement; and
- (9) Implementing and monitoring corrective actions.

The Department has developed an automated A-123 Assessment and Reporting Tool (AART) Suite in which to capture summary-level implementation information. However, completing the AART Tool Suite throughout the A-123 phases does not represent sufficient documentation, although it is a critical part. Source Documentation and A-123 Detailed Documentation supporting the information in the AART Tool Suite will be maintained locally and will be readily available in the event of an audit or other review.



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G. EVALUATING

The assessment of internal controls must include evaluation at the entity level and the process, transaction or application level. The SrAT will make an overall evaluation of the design and operation of the internal control over financial reporting based in large part on the quarterly and annual assessments from Heads of Departmental Headquarters and Field Elements.

Assessing Internal Controls at the Entity Level (Headquarters and Field)

Assessments of internal controls will include an evaluation of the five components (or standards) of internal controls. These components represent the minimum level of quality acceptable for internal controls and provide the basis against which internal controls are to be evaluated.

- a. Control Environment. The assessment of internal controls should include obtaining a sufficient knowledge of the control environment to understand management's attitude, awareness and actions concerning the control environment.
- b. Risk Assessment. The assessment of internal controls should include obtaining sufficient knowledge of the entity's process on how management considers risks relevant to financial reporting objectives and decides on actions to address those risks.
- c. Control Activities. Control activities are the policies and procedures that help ensure that management directives are carried out and that management's assertions in its financial reporting are valid. The assessment should include obtaining an understanding of the control activities applicable at the entity level.
- d. Information and Communications. The assessment should include obtaining an understanding of the information system(s) relevant to financial reporting.
- e. Monitoring. The assessment should include obtaining an understanding of the major types of activities the entity uses to monitor internal control over financial reporting, including the source of the information related to those activities and how those activities are used to initiate corrective actions.



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Entity level controls can have a pervasive effect on an organization. In order to maintain the consistency of entity control evaluations throughout the Department, the five entity level internal control components mentioned above—as well as 31 related entity sub-categories—are pre-defined in the AART Tool Suite. All 31 entity control sub-categories are documented, evaluated and tested as part of A-123 implementation.

All Departmental Elements implementing A-123 are required to document, evaluate and test entity level controls. These Departmental Elements include major site and facilities management contractors, Field Offices, Lead Program Secretarial Offices and Corporate Departments.

Assessing Internal Controls at the Process, Transaction, or Application Level (Headquarters and Field)

The SrAT will annually identify each financial report, significant account or group of accounts and major classes of transactions to be covered in the assessment based on risk assessments and materiality determinations. The A-123 Assessment Teams will perform the following as part of their assessments at the process, transaction, or application level:

- a. Evaluate, Based on Annual Guidance, the Major Accounts and Processes. The assessment will include obtaining an understanding of the specific processes and documented workflow involved in each class of transactions.
- b. Understand the Financial Reporting Process. The assessment will include obtaining an understanding of the process and workflow that links the accounting system to the financial report(s). Often times, financial information is not directly transferable from the accounting system to the financial report, but requires intervening calculations, summarizations, etc.
- c. Gain an Understanding of Control Design. The assessment will include preparing control evaluation(s) for each significant account or group of accounts that aligns specific controls with management's assertions for each account or group of accounts. An individual assessment of the potential effectiveness of the design of the in place controls for each account or group of accounts will be made considering the risk of error and the ability of the controls to prevent or detect such errors.
- d. Identify Controls Not Adequately Designed. The assessment will include determining whether controls established by management are designed effectively. Controls determined to be not designed effectively go straight into remediation.



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- e. Test Controls and Assess Compliance. The assessment will include testing those controls determined to be designed effectively.

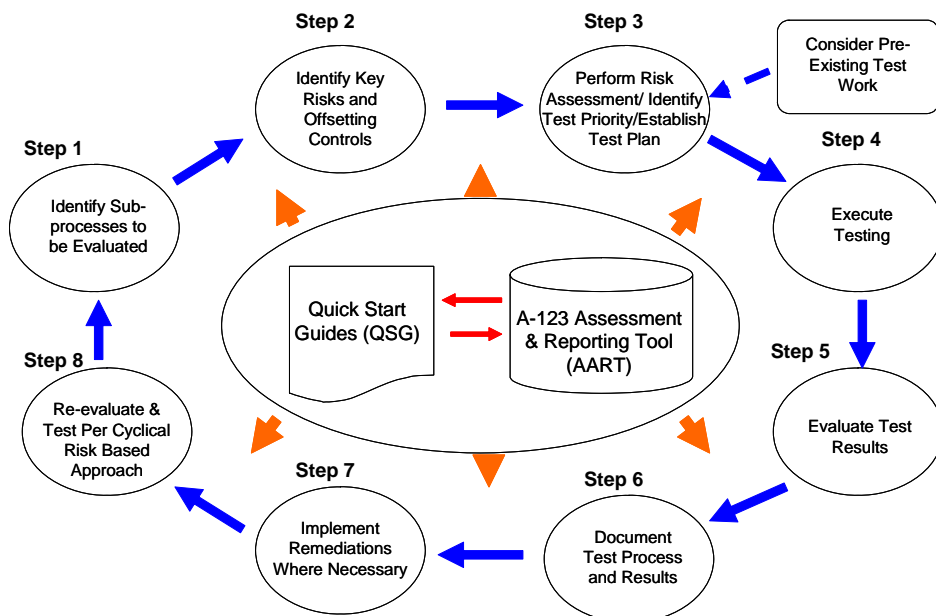
Process-level controls are assessed by major site and facilities management contractors, Field Offices, and certain LPSOs whose mission functions impact material accounts. All Departmental Elements implementing A-123 are not required to document, evaluate and test these "process level" controls.

LPSO	Process-Level Control Assessment
Office of Environmental Management	Environmental Liability
Office of Civilian Radioactive Waste Management	Environmental Liability, Contingencies and Commitments (Spent Nuclear Fuel Litigation Liability)
Office of Legacy Management	Environmental Liability, Pensions and Other Actuarial Liabilities

H. TESTING

The Department has developed a standard testing protocol that includes consideration of the results of control design effectiveness, relative risk and the overall impact of individual controls on financial reporting. The following chart provides a high-level overview of the Department's testing cycle.

Testing Cycle Overview





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I. REMEDIATION

As part of the Department's process for implementing A-123, reporting tools have been developed that track processes and controls requiring remediation. This will ensure that any systemic issues that result in qualification of the Department's A-123 assurance are adequately tracked until corrective actions have been taken and the related controls have been re-documented and tested. The SrAT will work with the responsible officials and personnel to determine which deficiencies are cost beneficial to correct. Corrective action plans, including targeted milestones and completion dates, will be obtained and progress will be monitored. The SrAT may, at its discretion, track findings considered to be less than a reportable condition.

J. REPORTING AND ASSURANCE

OMB A-123, Appendix A, requires the Secretary of Energy to make an annual assurance statement on the effectiveness of internal controls over financial reporting. In support of this requirement and to ensure there is a sound basis for the assurance statement, the SrAT requires quarterly reporting, annual assurances, and the identification of deficiencies. Based on this information, the SrAT will recommend to the CFO which reportable conditions, when aggregated, may be deemed material weaknesses to the Department as a whole. The SrAT will also consider these deficiencies when recommending to the CFO the level of Secretarial assurance the Department should provide on its internal control over financial reporting. The CFO, along with other senior management members of the DICARC, will make the final determination on which, if any, material weaknesses will be identified for the Department and the level of Secretarial assurance to be included in the PAR. To ensure accurate assessment and reporting of control effectiveness in the PAR, the SrAT will identify changes in the internal control environment from June 30th to fiscal year-end that could potentially impact the effectiveness of internal control over financial reporting.



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K. Oversight

The Department conducts oversight activities throughout all phases of A-123 implementation. Key oversight activities include: ensuring timely completion of A-123 milestones to meet Departmental commitments to OMB; ensuring that professional judgment decisions are reasonable; and ensuring the consistency, completeness and accuracy of data resulting from implementation efforts. Completion and documentation of these oversight activities allows the Department to identify and share best practices, as well as identify and resolve common problems, challenges and barriers to implementation.

The Department also monitors its A-123 implementation efforts on a routine and ongoing basis to help ensure compliance with OMB requirements and Departmental guidelines; and also ensure timely completion of A-123 milestones to meet Departmental commitments to OMB.

DOE IMPLEMENTATION RESOURCES

To facilitate Department-wide A-123 implementation, the PMT has developed Quick Start Guides based on the functional activities involved in implementing an A-123 assessment. In addition to the guides, various tools such as the AART Tool Suite and related materials have also been created. These guides, tools, and related materials assist in organizing, tracking, reporting and overseeing all A-123 activities and can be found on the DOE A-123 Website.